

BEFORE
THE PUBLIC SERVICE COMMISSION OF
SOUTH CAROLINA
DOCKET NO. 2003-293-C – ORDER NO. 2004-447
SEPTEMBER 24, 2004

IN RE: Savannah Valley Cablevision, Inc.,)	
)	ORDER DENYING AND
Complainant/Petitioner,)	DISMISSING
)	COMPLAINT
vs.)	
)	
West Carolina Rural Telephone Cooperative,)	
Inc. and West Carolina Communications,)	
LLC,)	
)	
Respondents.)	
_____)	

I. INTRODUCTION

This matter comes before the South Carolina Public Service Commission (“Commission”) upon the Complaint filed by Savannah Valley Cablevision, Inc. (“SVC”), dated October 1, 2003, against West Carolina Rural Telephone Cooperative, Inc. (“WCRTC”) and West Carolina Communications, LLC (“WCC”) (collectively, the “Respondents”).

By its Complaint, SVC alleges that WCRTC and WCC have violated the provisions of S.C. Code Ann. §§ 58-9-250 and 58-9-320, and 26 S.C. Code Ann. Regs. 103-603. SVC asked the Commission to issue an order requiring WCRTC to file its contracts with WCC for the Commission’s review and approval and requiring WCRTC to

prove that its dealings with the affiliated entity, WCC, are proper and in the public interest.

A public hearing was held in this matter on April 28, 2004. During the hearing, SVC was represented by Frank R. Ellerbe, III, Esquire. SVC presented the testimony of Jennings McAbee. In addition, SVC moved to place the confidential Deposition of David J. Herron into the record (under seal), as well as the Respondents' confidential responses to interrogatories and requests for the production of documents (under seal). These items were designated Hearing Exhibits 1 and 2, respectively.

WCRTC and WCC were represented by M. John Bowen, Jr., Esquire and Margaret M. Fox, Esquire. Respondents presented the testimony of David J. Herron. Counsel for Respondents also placed the remaining non-confidential responses to interrogatories and requests for the production of documents into the record. The non-confidential responses to interrogatories and requests for production of documents were designated Hearing Exhibit 3.

The Commission's Staff was represented by F. David Butler, General Counsel. The Commission Staff presented no witnesses.

The documents produced by WCRTC and WCC in response to SVC's requests that were entered into the record are as follows:

1. NECA Cost Reporting Guidelines for Apportionment of Costs for Nonregulated Services Including Digital Subscriber Line (DLS) and Video, dated March 24, 2003.
2. Infrastructure Sharing Agreement for Host Switching Services, Transport Services and Copper/Fiber Infrastructure Leasing, dated June 1, 2002, between WCRTC and WCC.

3. Billing and Collection Services Agreement, dated October 1, 1999, between WCRTC and WCC.
4. Management Services Agreement, dated October 1, 1999, between WCRTC and WCC.
5. Audited Financial Statement for West Carolina Rural Telephone Cooperative, Inc. and Subsidiary as of December 31, 2002 and 2001.
6. Audited Financial Statement for West Carolina Rural Telephone Cooperative, Inc. and Subsidiary as of December 31, 2001 and 2000.

These documents are included in Hearing Exhibit 2, with the exception of the NECA Cost Guidelines document, which is not confidential and is therefore included as part of Hearing Exhibit 3.

II. SUMMARY OF TESTIMONY

JENNINGS McABEE

SVC presented Jennings McAbee, Chairman of SVC. Mr. McAbee described SVC and testified regarding the history and financing of the company. Mr. McAbee testified that WCC's provision of cable services causes him concern because he believes WCC has an unfair advantage in competing with private cable companies. According to Mr. McAbee, WCC has no employees and has not incurred the normal costs of building or operating a cable system. Mr. McAbee further contends that WCC's parent company, WCRTC, receives state universal service funding for the same lines WCC uses to provide cable services and that it is unfair to use subsidized lines to provision services for competitive purposes. Mr. McAbee testified that the relief SVC seeks is to have the Commission order WCRTC to file with the Commission its contracts with WCC so that

the staff can review those contracts to determine whether WCRTC's dealings with WCC are proper and in the public interest.

DAVID J. HERRON

Respondents presented the testimony of David J. Herron, General Manager of WCRTC and President of WCC. Mr. Herron testified regarding the relationship between WCRTC and WCC. He testified that WCRTC provides certain services to WCC pursuant to contracts between the cooperative and its affiliate. These include a Management Services Agreement, an Infrastructure Sharing Agreement, and a Billing and Collection Agreement. The agreements, as well as applicable tariffs and Federal Communications Commission ("FCC") separations rules, govern the sharing of facilities and the provision of services between the two entities. According to Mr. Herron, WCC does not unfairly compete with SVC because WCC compensates WCRTC for all facilities and services used. The National Exchange Carriers Association ("NECA"), an entity formed in 1983 by the FCC, collects and validates cost and revenue data and files tariffs with the FCC to ensure compliance with the FCC's separations rules. Mr. Herron stated that WCC pays WCRTC the FCC-approved NECA tariffed rates for the provisioning of DSL and video services in WCRTC's service area and that WCRTC follows NECA's "Cost Reporting Guidelines" for the apportionment of costs for non-regulated services including DSL and video services. Mr. Herron further testified that WCRTC does not use State Universal Service Fund ("State USF") funding to provide competitive services. The only funds that WCRTC has drawn out of State USF represent a revenue replacement for the amount by which WCRTC reduced its access charges in

2001. The State USF is revenue neutral, and companies may only draw from the State USF after they have made a corresponding dollar-for-dollar reduction in other rates. Thus, there is no net revenue received by WCRTC as a result of its participation in the State USF that could be used in the provision of digital entertainment services by either WCRTC or WCC.

III. COMMISSION STAFF INVESTIGATION

Following the public hearing on this matter, the Commission directed WCRTC and WCC, pursuant to S.C. Code Ann. § 58-9-320, to provide within ten days to the Commission Staff any and all records and information belonging to them regarding or relevant to affiliated transactions, including any information concerning or relating to contracts or arrangements governing the transactions between those two companies. The Commission Staff was directed to review this information and prepare a report concerning the business arrangements, transactions, and contracts between the two companies and to provide a report to the Commission concerning this information and how, if in any way, such information affects the issues raised by SVC in this case.

The Commission Staff's Audit Department performed a review of the business arrangements and transactions between WCRTC and WCC as instructed by the Commission. On June 8, 2004, the Commission Staff filed with the Commission the "Commission Staff Report on West Carolina Rural Telephone Cooperative, Inc. Concerning Business Arrangements, Transactions and Contracts with West Carolina Communications, LLC" ("Staff Report"). The Commission Staff examined the books and records of WCRTC and WCC, as well as the various contracts governing the relationship

between the parent and its affiliate. In addition, the Commission Staff reviewed promissory notes, the Management Services Agreement, the time study conducted by WCRTC in August 2003, selected time records of non-management employees, the Billing and Collection Agreement, selected Carrier Access Billing System (CABS) bills sent from WCRTC to WCC, and the Infrastructure Sharing Agreement. The Commission Staff found procedures in place to properly segregate the operations of WCC from regulated telephone operations of WCRTC and concluded that the transactions between WCRTC and WCC appear to have been handled at arm's length. Advances made by WCRTC to WCC were kept at arm's length through the process of executing promissory notes and treating them on WCRTC's financial statements as advances to an affiliated company. The Commission Staff found one instance of an amount in accounts receivable for copper and fiber infrastructure that was booked incorrectly in 2003. This was corrected as a result of Staff's review, and the Commission Staff recommended that, in the future, WCRTC send a monthly bill to WCC for the use of copper and fiber infrastructure and that WCRTC record a receivable from WCC for the amount billed each month.

Following the filing of the Staff Report, the Commission's Executive Director caused the Staff Report to be served on the parties to this docket. The Executive Director also advised the parties that the parties had until June 22, 2004, in which to file briefs with the Commission regarding the Staff Report and the issues in this docket. SVC and WCRTC, jointly with WCC, filed briefs to address the Staff Report and to assert

positions related to the Staff Report and the matters asserted in the Complaint. The Staff Report and the briefs of the parties are made a part of the record before the Commission.

IV. FINDINGS OF FACT

Upon consideration of the evidence received at the hearing, the Staff Report, and the briefs submitted by the parties, the Commission makes the following Findings of Fact and Conclusions of Law:

1. The Complainant SVC, is a privately-held South Carolina corporation providing cable television services, and the majority of SVC's customers are residents of Savannah Lakes Village located in McCormick, South Carolina.

2. Respondent WCRTC is a South Carolina Telephone Cooperative organized and doing business under the laws of the State of South Carolina and provides service in the rural areas of Abbeville County, McCormick County, and the Starr/Iva areas of Anderson County. Respondent WCRTC provides various regulated services including basic residential and business services. Respondent WCC is a limited liability company organized and doing business under the laws of the State of South Carolina. WCC is a subsidiary of WCRTC and was formed to provide long distance service and other services, some of which are non-regulated services. WCC currently provides services such as paging, business services, inside wire and inside wire maintenance, internet services, digital entertainment services, and competitive local exchange service.

3. WCRTC provides certain services to WCC, including management services and billing and collection services, pursuant to contracts between WCRTC and

WCC. Additionally, WCRTC and WCC share facilities pursuant to an Infrastructure Sharing Agreement and pursuant to applicable tariff and FCC separations rules.

4. WCRTC and WCC are not required to file agreements with the Commission for approval prior to providing non-regulated services through an affiliate.

5. The agreements governing the relationship between WCRTC and WCC, an affiliate company of WCC, and the transactions between WCRTC and WCC are fair and reasonable and demonstrate an arm's length relationship.

6. The Commission finds no evidence of record to support the allegation that WCRTC is using the State Universal Service Fund to compete with SVC.

7. The Commission finds that the Complaint filed by SVC should be denied and dismissed.

V. CONCLUSIONS OF LAW

1. The nature of SVC as an entity operating in the State of South Carolina is evident from the Complaint filed by SVC and further was testified to and explained by Mr. McAbee. The business nature of the Complainant is not a contested issue.

2. The evidence concerning the nature of WCRTC and WCC as business entities is found in the Respondents' Answer and in the testimony of Mr. Herron. The business nature of the Respondents is not a contested issue but is provided for jurisdictional purposes.

3. Witness Herron testified regarding the existence of various contracts between WCRTC and WCC under which WCRTC provides various services to WCC.

Mr. Herron also provided testimony on the nature of services which the various contracts govern.

4. The Commission concludes that WCRTC was not required to file and have approved by the Commission contracts executed with an affiliate to provide non-regulated services.

The basic underlying premise of this case involves transactions between a regulated utility and an affiliate providing non-regulated services, in the instant case digital entertainment services. S.C. Code Ann. Section 58-9-320 deals with transactions between a regulated telephone utility and its affiliates and provides in pertinent part:

When in the judgment of the Commission there is a reasonably substantial affiliation of any telephone utility engaged in business in this State with any other corporation or person . . . the burden of proof shall be upon the telephone utility to establish as determined by the Commission the reasonableness, fairness, and absence of injurious effect upon the public interest of any fees or charges growing out of any transactions between any telephone utility and such other corporation or person. Every telephone utility shall be required to produce, if so ordered by the Commission . . . all such contracts, papers, and documents relating thereto and explanatory thereof as may be required by the Commission, and unless the reasonableness, fairness, and absence of injurious effect upon the public interest of such fees and charges are established as determined by the Commission, they shall not be allowed by the Commission for ratemaking purposes. . . .

This statute is directly on point and establishes the statutory standard by which the Commission examines affiliate transactions. A telephone utility is required to produce contracts, papers, and documents relating to transactions with its affiliates only if required to do so by the Commission. We conclude that the statute contains no requirement that a telephone utility file such affiliate transaction contracts and documents

in the absence of a Commission directive. We also conclude that the statute contains no requirement that the telephone utility have any contracts or transactions approved by the Commission prior to the affiliate's provision of non-regulated service.

SVC offers that S.C. Code Ann. Section 58-9-250 and Commission Regulation 26 S.C. Code Regs. 103-603 require that such contracts and documents be filed and approved prior to their being effective. However, we conclude that SVC's assertions are not correct for several reasons. First, Section 58-9-250 does not address or require the filing of contracts. Second, R. 103-603 is a regulation and does not take precedence over a statute, especially one that is as clearly worded as § 58-9-320. See Dalton v. United States, 816 F. 2d 971, 974 (4th Cir. 1987) (citing United States v. Doe, 701 F.2d 823 (9th Cir. 1983)) ("Where an administrative regulation conflicts with a statute, the statute controls"); see also Krauskopf v. Giannelli, 467 N.Y.S.2d 542, 544 (N.Y. Sup. Ct. 1983) ("[A] state statute must take precedence over a departmental regulation"). Third, S.C. Code Ann. § 58-9-250, pursuant to which SVC states R.103-603 was promulgated, does not deal specifically with affiliate transactions, but with an entirely different subject matter, i.e., discriminatory treatment of telephone utility customers. See Section 58-9-250 ("No telephone utility shall, as to rates or services, make or grant any unreasonable preference or advantage to any person or corporation or subject any person or corporation to any unreasonable prejudice or disadvantage.") There has been no allegation here that WCRTC offers discriminatory rates, terms, and conditions to SVC vis-à-vis any other WCRTC customer with respect to a service that WCRTC provides to SVC. Thus, Section 58-9-250 and, by extension, R. 103-603, is simply not applicable here. Finally,

even if S.C. Code Ann. § 58-9-320 and R. 103-603 were both applicable here, Section 58-9-320 takes precedence because it is a more specific statute that deals directly with the filing of contracts and documents relating to transactions between telephone utilities and their affiliates. It is well settled law that more specific statutes take precedence over general statutes. City of Rock Hill v. S.C. Dep't of Health and Environmental Control, 302 S.C. 161, 168, 394 S.E. 2d 327 (1990); Duke Power Co. v. S.C. Public Service Comm'n, 284 S.C. 81, 84, 326 S.E.2d 395 (1985).

The Commission's jurisdiction with respect to services it does not regulate, such as digital entertainment services, is that of ensuring that the appropriate safeguards are in place to ensure that non-regulated operations, expenses and revenues are separated out from regulated operations, expenses and revenues on the telephone utility's books for ratemaking purposes. See S.C. Code Ann. § 58-9-320.

SVC's contention that WCRTC was required to file its contracts with the Commission prior to transacting any business under those contracts must, therefore, be rejected because it is not consistent with the applicable statutes or with the Commission's statutory authority in this matter. As was pointed out during the hearing through redirect examination of Mr. Herron, there is nothing that prevents WCRTC from providing non-regulated services itself, without creating an affiliate. In such a case, expenses and revenues related to non-regulated services provided by WCRTC would be treated as "below the line" for ratemaking purposes, i.e., they would be separated out from regulated expenses and revenues on the books. However, as Mr. Herron testified, WCRTC chose to create a separate subsidiary to provide those services. The purpose for

doing so was to ensure a “clean separation” and keep the costs separate. If the services had been offered by WCRTC and accounted for on its books, there would have been no contracts and therefore no contracts to have approved. Likewise, once the subsidiary was created, there was no requirement to have contracts between WCRTC and WCC to govern their transactions. Any such transactions could have been accounted for by allocations on the books of the respective companies. According to Mr. Herron, however, again, the companies entered into contracts to ensure a clear separation.

SVC contends that WCRTC should have its agreements with WCC approved by the Commission before WCC can provide non-regulated services. If this were true, companies like WCRTC who take extra steps to ensure careful separations between regulated and non-regulated activities by creating subsidiaries and entering into arm’s length contracts would be subject to more regulatory scrutiny, including pre-approval of arrangements with affiliates, than would companies who do not take such careful measures. This cannot be what was intended. WCRTC went to great lengths to ensure that non-regulated activities were kept separate by creating a subsidiary, entering into contracts, performing a time study, requiring non-management employees to keep time sheets, and ensuring that WCC compensated WCRTC for all facilities and services used at appropriate tariff or contract rates. WCRTC should not be held to a higher standard than a company that does not undertake such efforts.

5. The Commission concludes that the agreements governing the relationship between WCRTC and WCC, as well as the transactions between WCRTC and WCC, are fair and reasonable and demonstrate an arm’s length relationship.

It appears to the Commission that the relief sought in the Complaint, and by the testimony of Witness McAbee, is for the Commission Staff to review the contracts between WCRTC and WCC to determine whether WCRTC's dealings with WCC are proper and in the public interest. As evidenced by the Staff Report submitted in this case, the Commission Staff has conducted such a review. The Commission Staff determined that the contracts and transactions between WCRTC and WCC were conducted at arm's length and that the respective companies' books and records are in accord. As reported by the Commission Staff, and as testified to by Mr. Herron, appropriate procedures are in place to properly segregate the operations of WCC from regulated telephone operations of WCRTC and the transactions between WCRTC and WCC are handled at arm's length.

Mr. Herron testified concerning the arm's length relationship between the companies. In addition, Mr. Herron answered in detail numerous questions concerning the relationship and transactions between WCRTC and WCC during a deposition conducted by SVC's counsel on March 26, 2004 ("DJH Deposition"). Through his testimony and deposition responses, Mr. Herron stated that WCC has the local franchise and FCC authority it needs in order to provide digital entertainment services in WCRTC's service area. DJH Deposition at 16. Mr. Herron explained that WCC compensates WCRTC for all facilities and services used. See Prefiled Testimony of David J. Herron ("DJH Testimony") at 3-4; DJH Deposition at 31-40. WCRTC provides certain services to WCC, including management services and billing and collection services. Those services are provided pursuant to contracts between WCRTC and WCC. DJH Testimony at 3. Under the Management Services Agreement, WCC pays WCRTC a

monthly management fee in addition to out-of pocket expenses and direct costs incurred by WCRTC on WCC's behalf. DJH Testimony at 3; DJH Deposition at 68. Labor is a direct cost that is reported and reimbursed by WCC to WCRTC based on the actual time sheet of the employee and the loaded labor rate, which includes overhead. DJH Deposition at 69. The loaded labor rate fluctuates monthly in accordance with FCC rules of accounting. DJH Deposition at 85. Management personnel's time is allocated based on a time study conducted by telecommunications consultant John Staurulakis, Inc. ("JSI"). DJH Deposition at 46, 70.

Mr. Herron also testified that WCRTC and WCC have an Infrastructure Sharing Agreement. That agreement, along with applicable tariffs and FCC separations rules, governs the sharing of facilities between WCRTC and WCC. DJH Testimony at 3. The rates contained in the Infrastructure Sharing Agreement were developed by JSI. DJH Deposition at 86. In addition to the contract for the sharing of facilities, there are FCC-approved NECA tariffs that apply to the provisioning of DSL and video services in WCRTC's service area. DJH Testimony at 3. WCC pays NECA wholesale tariff rates to WCRTC for the provisioning of video services to customers located in WCRTC's service area, including the Savannah Lakes area that is at issue here. DJH Testimony at 3, DJH Deposition at 82. Those tariffed rates do not favor WCC, as they would be applicable to anyone who qualifies. See DJH Deposition at 35. Mr. Herron also testified that WCRTC follows NECA's "Cost Reporting Guidelines" for the apportionment of costs for non-regulated services including DSL and video services. DJH Testimony at 3. WCRTC and WCC also have a Billing and Collection Agreement. That agreement governs interstate

services, as well as intrastate services where there is not a conflict with the state tariff. DJH Deposition at 74-75.

With respect to the specific services at issue here – i.e., video services provided by WCC to customers in WCRTC’s service area (Savannah Lakes) – Mr. Herron explained that these services are provided pursuant to NECA tariffs rather than the Infrastructure Sharing Agreement. DJH Deposition at 82. More specifically, for the provision of high speed internet and video services to customers in WCRTC’s service area, WCC pays to WCRTC the NECA tariffed wholesale rate on a per-customer basis for DSL and broadband services. See DJH Deposition at 34-38. Video is priced on a “per stream” basis depending upon the bandwidth needed. DJH Deposition at 34-38. The NECA tariff rates are available to anyone who qualifies under the same circumstances. DJH Deposition at 35.

The Commission Staff’s audit and the resulting Staff Report also support the conclusion that WCRTC and WCC operate at arm’s length. The Commission Staff’s Audit Department performed a review of the business arrangements and transactions between WCRTC and WCC as instructed by the Commission, and the Commission Staff issued its Staff Report following its audit and review. The Commission Staff examined the books and records of WCRTC and WCC, as well as the various contracts governing the relationship between the parent and its affiliate. In addition, the Commission Staff reviewed promissory notes, the Management Services Agreement, the time study conducted by WCRTC in August 2003, selected time records of non-management employees, the Billing and Collection Agreement, selected Carrier Access Billing System

(“CABS”) bills sent from WCRTC to WCC, and the Infrastructure Sharing Agreement. The Commission Staff found procedures in place to properly segregate the operations of WCC from regulated telephone operations of WCRTC, and the Commission Staff concluded that the transactions between WCRTC and WCC appear to have handled at arm’s length.

SVC presented no testimony or evidence to dispute the arm’s length nature of the relationship and transactions. As Mr. McAbee testified, “Savannah Valley Cable does not have the financial resources to hire experts to examine these arrangements.” Testimony of Jennings McAbee at 6.

The uncontroverted evidence of record shows that appropriate procedures are in place to properly segregate the operations of WCC from regulated telephone operations of WCRTC and that the transactions between WCRTC and WCC are handled at arm’s length. WCC compensates WCRTC for all facilities and services used, and those transactions are properly accounted for on the books of the respective companies and through promissory notes, time studies, time sheets, CABS bills, and other records.

6. The Commission concludes that WCRTC is not using the State USF to compete with SVC.

Mr. Herron testified that WCRTC does not use State USF funding to provide competitive services. DJH Testimony at 4. The only funds that WCRTC has drawn out of State USF represent a revenue replacement for the amount by which WCRTC reduced its access charges in 2001. Id. The State USF is revenue neutral, and companies may only draw from the State USF after they have made a corresponding dollar-for-dollar

reduction in other rates. Id.; see also Commission Order No. 2001-419 at 42; Section 4 of the State USF Guidelines, attached as Exhibit A to Commission Order No. 2001-996. There is no net revenue received by WCRTC as a result of its participation in the State USF that could be used in the provision of digital entertainment services by either WCRTC or WCC. Id. Further, there is no evidence presented to support SVC's contention that WCRTC is using the State USF to subsidize WCC or to compete with SVC.

7. The Commission concludes that the Complaint filed by SVC should be denied and dismissed.

After hearing the evidence in this case and considering the findings and conclusions in this Order, the Commission concludes that the Complaint filed by SVC should be denied and dismissed. The relief sought by SVC's Complaint in this matter was to require WCRTC to file its contracts with WCC for Commission review and approval and to require WCRTC to prove that its dealings with WCC are proper and in the public interest. The Commission has found and concluded, after examining the record in this proceeding which includes the Staff Report issued following the Commission Staff's audit, (1) that WCRTC was not required to file the agreements between WCRTC and WCC; (2) that WCRTC was, and is, not required to have agreements approved by the Commission prior to providing non-regulated service, either itself or through an affiliated company; (3) that the agreements between WCRTC and WCC are just and reasonable and clearly demonstrate an arm's length relationship; and (4) that the transactions between WCRTC and WCC are fully documented on the books and records of the

respective companies, are just and reasonable, and demonstrate that the companies' dealings with one another are transacted at arm's length. Accordingly, because the Commission has found that approval of contracts between WCRTC and WCC was not required and that the agreements and transactions between WCRTC and WCC appear just and reasonable and demonstrate an arm's length relationship, the Commission concludes that the Complaint of SVC should be denied and dismissed.

On April 13, 2004, Respondents filed a written motion to dismiss SVC's complaint. Upon consideration of the Motion prior to the hearing, the Commission held the Motion to Dismiss in abeyance. At the close of SVC's case, counsel for Respondents renewed the Motion to Dismiss and moved for a directed verdict. At the hearing, the Motion was taken under advisement. Because the Commission has determined the allegations of the Complaint to be without merit, the Commission need not rule on the Motion to Dismiss.

IT IS THEREFORE ORDERED, ADJUDGED, AND DECREED THAT:

1. The Complaint filed by SVC is denied and hereby dismissed.

2. This Order shall remain in full force and effect until further Order of the Commission.

BY ORDER OF THE COMMISSION:

/s/
Randy Mitchell, Chairman

ATTEST:

/s/
G. O'Neal Hamilton, Vice Chairman

(SEAL)